

Finance for Non-Finance

Financial Accounting

Generally Accepted Accounting Principles and Concepts

Entity: A separate economic unit. Should be kept distinct from the activities of its owners and other companies

Monetary Unit: Economic events having monetary transactions to be reported in the financial statements

Going Concern: Companies will operate for an indefinitely long duration

Cost Principle: Assets are presented at their original cost

Periodicity: Use of discrete time periods for reporting economic activities of a firm

Matching Principle: Revenues to be recorded in accounting period in which goods are sold or services are rendered. Expenses to be recorded in the same accounting period in which they are incurred for get such revenue.

Comparison of different Accounting Types

Basis	Financial Accounting	Cost Accounting	Management Accounting
Objects	Record transactions & determine financial position & profit or loss.	Ascertainment, allocation, accumulation and accounting for cost	To assist the management in decision-making & policy formulation.
Nature	Concerned with historical data.	Concerned with both past and present recorded (historical in nature).	Deals with projection of data for the future (futuristic in nature)
Principle Followed	Governed by GAAP	Certain principles followed for recording costs.	No set principles are followed in it.
Data used	Qualitative aspects are not recorded	Only quantitative aspect is recorded.	Uses both quantitative and qualitative concepts.

Definition – Financial Statements

- ❖ Structured representation of the financial position and financial performance and cash flows of an entity.
- ❖ Used by Stakeholders to evaluate a company's financial health & earning potentials.
- ❖ Prepared & governed as per the provisions of Companies Act 2013 and Accounting Standards and Guidelines issued by the Institute of Chartered Accountants of India.
- ❖ Are audited by auditors who may be Chartered Accountant or a Firm of Chartered Accountants.
- ❖ Are subject of Audit. In case of Govt. Companies & CPSEs, the auditors are nominated by CAG.



Financial Statement are majorly classified into three (3) types:

- **Balance Sheet**
 - Assets, Liabilities, Owner's Equity or Net Worth
- **Statement of Profit and Loss (P&L Account)**
 - Revenue, Expenditure, Income (Profit/Loss)
- **Cash Flow Statement**
 - Activities – Operating, Investing & Financing

Balance Sheet provides the financial condition (Assets, Liabilities, Owner's Equity) of any business entity on a given date. The information can be used to analyze the financial stability and business performance. Typical BS is shown below:

Assets = Liabilities + Owner's Equity

Various Terms used in a Balance Sheet are explained in the following slides.

- Assets – Anything that has value and owned by a company
- Liabilities – This provides a list of debts a company owes to others
- Capital or Equity- This is the amount invested by the Shareholders

<u>Balance Sheet of Maynard Company as on June 1</u>			
Assets		Liabilities & Owner's Equity	
Current Asset (CA)	in Dollars (\$)	Current Liabilities (CL)	in Dollars (\$)
Accounts Receivables	21798	Accounts Payable	8517
Cash	34983	Accrued Wages payable	1974
Merchandise Inventory	29835	Bank notes payable	8385
Note receivable, Diane Maynard	11700	Taxes payable	5700
Prepaid Insurance	3150	Total Current Liabilities (CL)	24576
Supplies on Hand	5559		
Total Current Asset	107025	Long-Term Liabilities (LTL)	2451
		Total Long-Term Liabilities (TLTL)	2451
		Total Liabilities	27027
Non-Current Asset (NCA)	in Dollars (\$)	Owner's Equity (OE)	
Building (net of depreciation)	429000	Capital Stock	390000
Equipment (net of depreciation)	7956	Retained Earnings (RE)*	221511
Land	89700	*from Income Statement (profit)	
Other Noncurrent Assets	4857	Total Owner's Equity (OE)	611511
Total Non-Current Asset (NCA)	531513		
		Total Liabilities & Owner's Equity	638538
Total Assets	638538		

Terms used in preparing Balance Sheet (1/2 slides):

Section	Sub-Section	Description
Current Asset	Cash	Can be liquidated within a short period of time. Cash is most liquid form of these assets and includes all funds contained in checking, saving, and money market accounts.
	Accounts Receivable	Amount to be received from the customers also known as debtors . These receivables exist from the time the client is billed to the time the company receives payment from the customer.
	Inventory	Items that a company purchases/manufactures and then sells to the customers. From the time the goods/raw material are purchased or processed to the time, it is sold to the customer, these are termed as inventories.
Fixed Asset	Plant, Buildings, Equipments	Physical assets owned by the company for a long term. Long term assets are generally depreciated over time and so these assets are recorded with a total accumulated depreciation amount subtracted from them.
	Vehicle	Vehicle is a long-term asset held by the company (> a year) and it is depreciated over the time.
	Land	Land is a fixed asset and held for a longer period of time than any other long-term asset. It is one of the fixed assets which is not depreciated instead value of the land increases as the years pass.
Intangible Asset	Goodwill	Goodwill is an intangible asset which represents non-physical assets that add to a company's value but cannot be easily identified or valued

Terms used in preparing Balance Sheet (2/2 slides):

Section	Sub-Section	Description
Current Liability	Accounts Payable	Obligations that will become due in the current period (within a year) and generally includes trade due to suppliers. It is amount due to creditors for services or goods that have not yet been paid
	Accrued Expenses	Obligations recognized in the books but are not yet due, and include wages, interest etc.
	Taxes Payable	Amount of taxes that a company owes to the government. All taxes are generally due to be paid within a year and hence classified as current liability
Long Term Liability	Long Term Debt	Those obligations which will not be payable within the current year and will become due in more than one year. It represents the total amount due to be paid by the company to third parties and creditors for over a year or more.
Share Holder's Equity	Capital Stock	Capital represents the money invested by the owner in the business and it is the total assets minus the total liabilities. Capital stock changes according to the organisation type – companies report capital as common stock, preferred stock etc. whereas Partnerships list the Partner's capital.
	Retained Earning	This is the excess earnings retained by the entity to invest in the business. This represents the amount not paid to share holder as dividend

Balance Sheet

as at March 2019

Particulars	NOTE	As at	As at
		March 31st 2019	March 31st 2018
I. ASSETS			
(1) Non Current Assets			
(a) Property, plant and equipment			
(b) Capital work-in-progress			
(c) Intangible assets			
(d) Intangible assets under development			
(e) Financial Assets			
i) Investments			
ii) Trade Receivable			
iii) Loans			
iv) Other financial assets			
(f) Deferred tax assets (net)			
(g) Other Non Current Assets			
Total Non Current Assets	A	-	-

**Sample
Representation**

Balance Sheet

as at March 2019

Particulars	NOTE	As at	As at
		March 31st 2019	March 31st 2018
(2) Current assets			
(a) Inventory			
(b) Financial Assets			
i) Investments			
ii) Trade receivables			
iii) Cash and cash equivalents			
iv) Bank Balance others than (iii) above			
v) Loans			
vi) Others			
(c) Current Tax Assets (Net of provisions)			
(d) Other current assets			
Total Current Assets	B	-	-
(4) Inter division accounts (Dr. bal.)	C		
(5) Funds to & from corp. off -CCC A/c (Dr. bal.)	D		
Total Assets	(A to D)	-	-

Sample
Representation

Balance Sheet

as at March 2019

Particulars	NOTE	As at	As at
		March 31st 2019	March 31st 2018
II . EQUITY AND LIABILITIES			
(1) Equity			
(a) Equity share capital			
(b) Funds from head office			
(c) Other Equity	E		
(2) Inter division accounts (Cr Bal)	F		
(3) Funds to & from corp. off -CCC A/c (Cr. Ba	G		
Total Equity	(E+F+G)	.	.

Sample
Representation

Balance Sheet

as at March 2019

Particulars	NOTE	As at	As at
		March 31st 2019	March 31st 2018
(4) Non-current liabilities			
(a) Financial Liabilities			
i) Borrowings			
ii) Trade Payable			
(i) Total outstanding dues of micro and small enterprises			
(ii) Total outstanding dues of creditors other than micro and small			
iii) Other financial liabilities			
(b) Provisions			
(c) Other non-current liabilities			
Total Non Current Liabilities	H	-	-
(5) Current Liabilities			
(a) Financial Liabilities			
i) Borrowings		-	-
ii) Trade Payable			
(i) Total outstanding dues of micro and small enterprises			
(ii) Total outstanding dues of creditors other than micro and small			
iii) Other financial liabilities			
(b) Provisions			
(c) Other current liabilities			
Total Current Liabilities	I	-	-
Total Liabilities	(H+I)	-	-
TOTAL EQUITY AND LIABILITIES		-	-

Sample
Representation

Analysis of Balance Sheet

In order to analyze the Balance sheet of an Entity, Many Parameters are considered by the readers of Financial Statement that depends on type of industry. For eg:

To analyze liquidity position of an Entity:

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

Ideal current ratio is 2:1 but still it can vary for different types/sizes of business.

$$\text{Quick Ratio} = \frac{\text{Quick Assets}}{\text{Current Liabilities}}$$

Quick assets refer to current assets which can be converted into cash immediately or at a short notice .It includes all current assets except prepaid expenses and inventories.

Analysis of Balance Sheet

To analyze the long term solvency of an Entity:

$$\text{Debt Equity Ratio} = \frac{\text{Long Term Debts}}{\text{Shareholders Equity}}$$

Debt equity ratio indicates the margin of safety to the creditors . For e.g. D/E ratio is 1:2. It implies that for every rupee of outside Liability ,the firm has two rupees of owner's capital.

$$\text{Interest Coverage Ratio} = \frac{\text{Earning before Interest \& Tax}}{\text{Interest on Long Term Loans}}$$

- A higher ratio indicates higher safety to the creditors for getting interest.
- A low ratio is a Red signal that the firm is using excessive debt and does not have the ability to offer assured payment of interest to the creditors.

Statement of Profit and Loss (P&L)

Summarizes the revenues, costs, and expenses incurred during a specified period, usually a fiscal quarter or year.

Provides information about a company's ability or inability to generate profit by increasing revenue, reducing costs, or both.

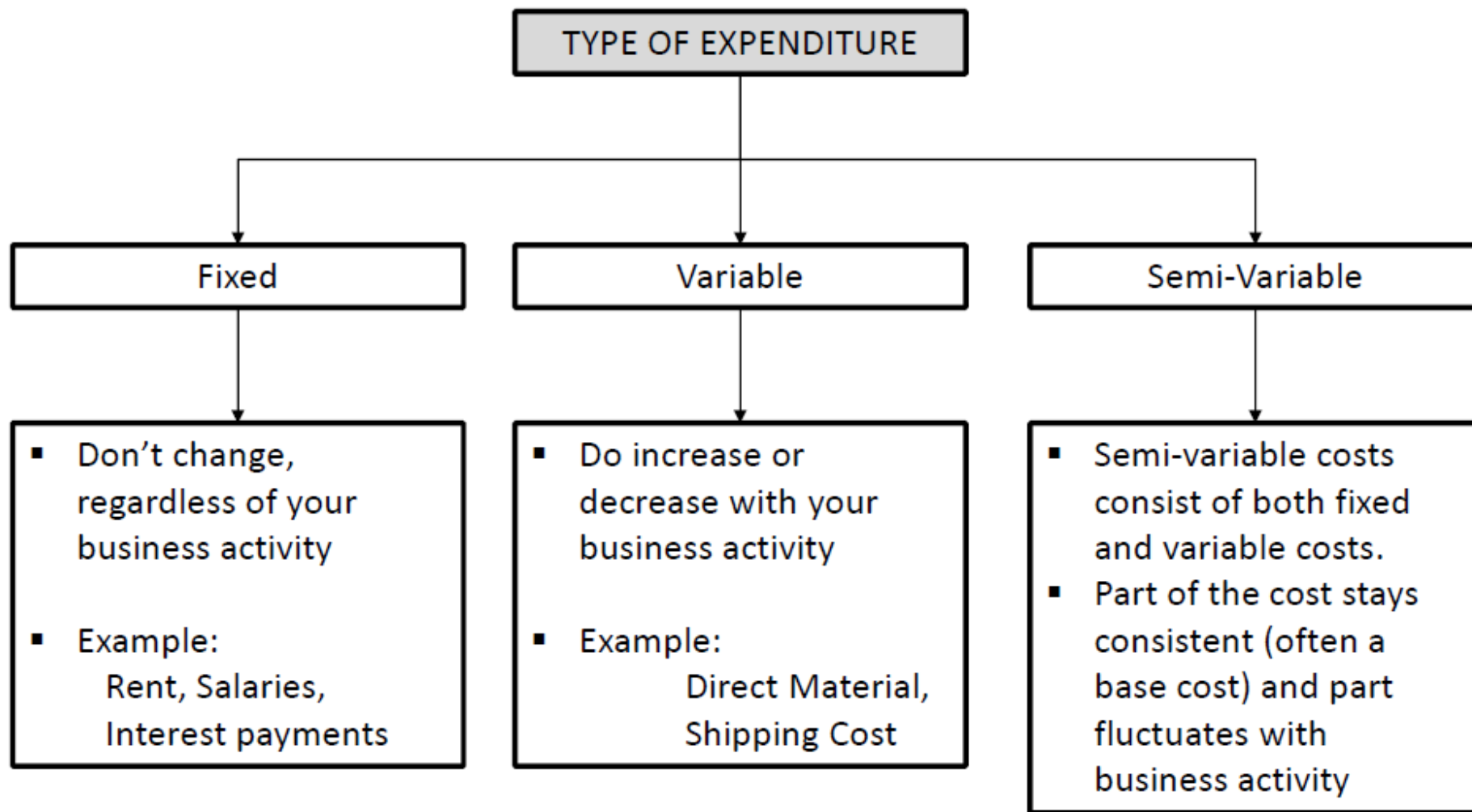
Some refer to the P&L statement as a statement of profit and loss, Income Statement, statement of operations, statement of financial results or income, earnings statement or expense statement.

A typical
Income
Statement is
shown here ↓

One can use the income statement to calculate several metrics, including the gross profit margin, the operating profit margin, the net profit margin and the operating ratio.

Income Statement of Maynard Company for the month of June						
					explanation	
Sales Revenues				\$49,127	Cash plus credit sales	
	Cash Sales	\$44,420				
	Credit Customers	\$4,707			(26505-21798)	
Expenses						
Cost of goods sold				\$31,428	inventory plus supplies	
	Inventory (Merchandise)	\$18,030			(29835+14715-26520)	
	Supplies	\$600			(5559+1671-6630)	
	Vendor Payables	\$12,798			(21315-8517)	
Wages paid				\$228	(2202-1974)	wages to employees
Utility Bills				\$900	utility expense	
Taxes				\$1,524	(7224-5700)	
Depreciation on Equipment				\$624	(5928-5304)	
Depreciation on Building				\$1,950	(157950-156000)	
Prepaid Insurance				\$324	(3150-2826)	
Miscellaneous payments				\$135	miscellaneous expenses	
Total Expenses				\$37,113		
Net Income				\$12,014		

Type of Expenditures



Analysis of Profit & Loss Statement

In order to understand the Profitability Status of an Entity, Many Parameters are considered by the readers of Financial Statement that depends on type of industry.

For an Org, following Parameters are quite crucial:

- Direct Material as a % of Turnover
- Value added as a % of Turnover
- Operating Profit as a % of Turnover
- PBT as a % of Turnover
- Employee benefit as a % of Turnover

Analysis of Profit & Loss Statement

Other Commonly used Profitability Ratio are as under:

$$\text{RETURN ON INVESTMENT (ROI) = } \frac{\text{Net Profit Before/After Tax}}{\text{Total Capital Employed}}$$

$$\text{RETURN ON INVESTMENT (ROI) = } \frac{\text{Net Profit available for Equity Share holders}}{\text{No of Equity Shares}}$$

$$\text{PRICE EARNING RATIO (PE RATIO) = } \frac{\text{Market Price Per Share}}{\text{Earning Per Share}}$$

$$\text{DIVIDEND PAYOUT RATIO = } \frac{\text{Total Dividend to Equity Share holder}}{\text{Total Net Profit belongs to Equity Shareholders}}$$

The **Cash Flow Statement (CFS)** shows the business entity or the Company's Cash Inflow (generation) and Outflow (absorption) over a period of time. It traces and reports the movement of Cash & Cash equivalents in the functioning of the organization.

Differences between Income Statement and Cash Flow Statement:

- Timing Differences (Working Capital Activities)
- Capital Expenses Vs Operating Expenses (Investment Activities)
- Financing Inflows/Outflows not included in the Income Statement (Financing Activities)

Represents the changes from last Year's Balance Sheet to this Year's Balance Sheet:

- Asset goes Up = Cash Negative
- Asset goes down = Cash Positive
- Liability goes up = Cash Positive
- Liability goes down = Cash Negative
- Owner's Equity goes up = Cash Positive
- Owner's Equity goes down = Cash Negative

Typical CFS is shown below for a given duration:

	in \$
Opening Balance of Cash	25000
Receipts	2000
Total Cash	27000
Payments	
Rent	500
Inventory (Office supplies)	500
Advertising	750
Salaries	3000
Equipment	5000
Total Payments	9750
Closing Balance of Cash	17250

Cash Flow Statement

Operating Activities

The amount of Cash flow arising from operating activity is a key indicator that Operations of the entity has generated sufficient cash flow to pay the Operating Expenses.

- Cash receipts from the sale of goods and the rendering of services;
- Cash receipts from royalties, fees, commissions and other revenue;
- Cash payments to suppliers for goods and services;
- Cash payments to and on behalf of employees;
- Cash receipts and cash payments of an insurance entity for premiums and claims, annuities and other policy benefits;
- Cash payments or refunds of income taxes unless they can be specifically identified with financing and investing activities;

Investing Activities

The amount of Cash flow from acquisition and disposal of long term assets and other investments not included in cash equivalents

e.g. sale / purchase of fixed assets, loans and advances etc.

Financing Activities

Activities that result in changes in the size and composition of owner's capital and borrowings of the enterprise.

e.g. issue of shares, debentures, loans etc. and repayments thereof.

The Balance Sheet, Cash Flow Statement and the Income Statement - Together - provide an in-depth look at a company's financial performance.